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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1998

STATE OF ARKANSAS

Petitioner

vs.

FARM CREDIT SERVICES OF CENTRAL ARKANSAS, PCA; FARM CREDIT SERVICES OF WESTERN ARKANSAS, PCA; EASTERN ARKANSAS PRODUCTION CREDIT ASSOCIATION; and DELTA PRODUCTION CREDIT ASSOCIATION

Respondents

ON PETITION FOR WRIT OF CERTIORARI
TO THE SUPREME COURT OF ARKANSAS

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Does Congress' statutory designation of production credit associations as "federal instrumentalities" entitle them to constitutional immunity from state taxation under the doctrine of intergovernmental tax immunity going beyond the express tax immunity afforded them by 12 U.S.C. § 2077.

LIST OF PARTIES

The parties to this proceeding are the same as the parties to the proceeding below. The petitioner is the State of Arkansas, through the Department of Finance and Administration. The respondents are four production credit associations chartered by the Farm Credit Administration, including Farm Credit Services of Central Arkansas, PCA; Farm Credit Services of Western Arkansas, PCA; Eastern Arkansas Production Credit Association; and Delta Production Credit Association.

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ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF ARKANSAS

The petitioner State of Arkansas respectfully prays that a writ of certiorari issue to review the judgment and opinion of the Supreme Court of Arkansas, entered in the above-entitled proceeding on July 1, 1999.

OPINIONS BELOW

The opinion of the Supreme Court of Arkansas is reported at 338 Ark. 322 (1999) and is reprinted in its entirety at Appendix A hereto. The Order of the Chancery Court of Pulaski County, Arkansas, First Division, is unreported and is reprinted in its entirety at Appendix B hereto.

JURISDICTION

The respondents brought this suit in the Chancery Court of Pulaski County, Arkansas, First Division claiming their exemption from state taxation as "federal instrumentalities" under the Supremacy Clause (Article VI, Clause 2) of the Constitution of the United States. On July 1, 1998, the chancery court granted the respondents' motion for summary judgment. (P. App. B1-3).

On petitioner's appeal, the Supreme Court of Arkansas affirmed the decision of the chancery court holding that respondents are exempt from state taxation as federal instrumentalities and entered a judgment awarding respondents a refund of state taxes which respondents claimed were paid in error. The Opinion of the Supreme Court of Arkansas was delivered on July 1, 1999 (P. App. A1-6).

This petition is filed within the time allowed by law. The jurisdiction of this Court to review the judgment of the Supreme Court of Arkansas is invoked pursuant to 28 U.S.C. § 1257.

CONSTITUTIONAL PROVISIONS INVOLVED

Article VI, Clause 2 of the United States Constitution provides in pertinent part:

> This Constitution, and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land . . ..

STATUTORY PROVISIONS INVOLVED

[Pertinent text is set forth verbatim in Appendix C as provided in Rule 14.1(f) of the Rules of the Supreme Court.]

12 U.S.C. § 2071
12 U.S.C. § 2077

STATEMENT OF THE CASE

1. The respondents are four Arkansas Production Credit Associations chartered by the Farm Credit Administration as provided by the Farm Credit Act of 1971, Pub. L. No. 92-181, 85 Stat. 583, as amended (12 U.S.C. 2001 *et seq.*). Production credit associations (PCAs) are entities of the Farm Credit System, a government sponsored enterprise created by Congress in 1916 to provide agricultural credit to American farmers. The Federal Farm Loan Act, Pub. L. No. 64-158, 39 Stat. 360 (1916) established twelve district Federal land banks to make long-term loans to farmers through Federal land bank associations.

The Farm Credit Act of 1933, Pub. L. No. 73-98, 48 Stat. 257 (1933) established the Farm Credit Administration, an independent federal agency with responsibility to oversee the banks and associations comprising the System. The 1933 Act also established Production Credit Associations to provide short term credit to farmers and ranchers through loans from Federal Intermediate credit banks, Banks for Cooperatives to make loans and provide credit services to agricultural cooperatives, the Central Bank for Cooperatives, and Production Credit Corporations. Congress established two classes of PCA stock, one to be owned by the United States through the Production Credit Corporations, and the

second to be owned by the farmer borrowers. Farm Credit Act of 1933, ch. 98, § 23, 48 Stat. 260 (1933).

Congress designated PCAs, like the other entities in the Farm Credit System, as "instrumentalities of the United States" in the 1933 Act. Farm Credit Act of 1933, ch. 98, § 63, 48 Stat. 267 (1933). The same section of the Act specifically exempted their notes, debentures, bonds, and other obligations from all federal, state, Territorial, and local taxation, except surtaxes, estate, inheritance, and gift taxes. The section also exempted the association itself, its property, its franchises, capital, reserves, surplus and other funds, and its income from all taxation, except that the real and tangible personal property of the associations was subject to tax to the same extent as other similar property. Although the exemption for the obligations was unconditional, the exemption for the association, its property, and its income applied only so long as the Production Credit Corporation owned stock in the association. *Id.*

In 1971, Congress amended the Farm Credit Act, rewriting most of the statutory authority for the Farm Credit System to "modernize and streamline" the System. H. R. Rep. No. 593, 92d Cong., 1st Sess., *reprinted in* 1971 U.S. Code Cong. & Admin. News 2091, 2092. Although by 1971 the government no longer owned any PCA stock, *Id.* at 2098, Congress provided that the Governor of the Farm Credit Administration could purchase stock in the various System entities, including PCAs, during financial emergencies to assist the associations to meet their borrowers" credit needs. Pub. L. No. 92-181, § 4.0, 85 Stat. 609 (1971). The Act provided for each PCA to "continue as a Federally chartered instrumentality of the United States." Pub. L. No. 92-181, § 2.10, 85 Stat. 597 (1971). Congress preserved both exemptions from taxation for PCAs. The PCA taxation statute, as amended, read:

> Each production credit association and its obligations are instrumentalities of the United States and as such any and all notes, debentures, and other such obligations issued by such associations shall be exempt, both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority. *Such associations, their property, their franchises, capital, reserves, surplus, and other funds, and their income shall be exempt from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority; except that interest on the obligations of such associations shall be subject only to Federal income taxation in the hands of the holder thereof pursuant to the Public Debt Act of 1941 (31 U.S.C. 742(a)) and except that any real and tangible personal property of such associations shall be subject to Federal, State, Territorial, and local taxation to the same extent as similar property is taxed. The exemption provided in the preceding sentence shall apply only for any year or part thereof in which stock in the production credit associations is held by the Governor of the Farm Credit Administration.*

Pub. L. No. 92-181, § 2.17, 85 Stat. 583, 602 (1971) (emphasis added) (current version at 12 U.S.C. § 2077).

In 1985, in response to the crisis in the agricultural economy, Congress enacted the Farm Credit Amendments Act, Pub. L. No. 99-205, 99 Stat. 1678 (1985), to reorganize and strengthen the Farm Credit Administration by removing it from day-to-day participation and making it an "arm's-length" regulator. H. R. Rep. No. 425, 99th Cong., 1st Sess., *reprinted in* 1985 U.S. Code Cong. & Admin. News 2587,

2589. As a part of the reorganization, Congress repealed the Governor's authority to invest directly in production credit associations and created the Farm Credit System Capital Corporation to provide financial and technical assistance to System institutions. Pub. L. No. 99-205, § 101, 99 Stat. 1678; H.R. Rep. No. 425, *supra*, at 2601-2602.

Section 205 of the Act included "numerous technical and conforming amendments" to reflect "changes in the basic powers, duties and authorities of the Farm Credit Administration" and to "conform specific sections of the Act to the change made by . . . the elimination of the authority to make separate investments in individual institutions." H. R. Rep. No. 425, *supra*, at 2615. Among the technical and conforming amendments was an amendment to the PCA taxation section "striking out the last two sentences of section 2.17," italicized above, that exempted the association, its property, its funds, and its income from taxation so long as the government owned PCA stock. Pub. L. No. 99-205, § 205, 99 Stat. 1705 (1971).

Presently, the taxation of production credit associations is addressed at 12 U.S.C. § 2077,[1] as follows:

> Each production credit association and its obligations are instrumentalities of the United States and as such any and all notes, debentures, and other obligations issued by such associations shall be exempt, both as

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[1] The present language of 12 U.S.C. § 2077 is substantially the same as that of then Section 2098 following the 1985 amendment. The Agricultural Credit Act of 1987, Pub. L. No. 100-233, § 401, 101 Stat. 1633, redesignated Section 2098 as Section 2077 without any change to the text. The Agricultural Credit Technical Corrections Act of 1988, Pub. L. No. 100-399, § 401(r), 102 Stat. 998, amended Section 2077 by inserting a comma after "interest" and by adding "except that interest on such obligations shall be subject to Federal income taxation in the hands of the holder" after "authority."

> to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any State, territorial, or local taxing authority, except that interest on such obligations shall be subject to Federal income taxation in the hands of the holder.

12 U.S.C. § 2077 (1989).

In addition to 12 U.S.C. § 2077, production credit associations are designated as federal instrumentalities in 12 U.S.C. 2071, as follows:

> Each production credit association shall continue as a Federally chartered instrumentality of the United States.

12 U.S.C. § 2071(a).

> On approval of the proposed articles by the Farm Credit Administration, and on the issuance of a charter, the association shall become as of such date a federally chartered body corporate and an instrumentality of the United States.

12 U.S.C. § 2071(b)(7).

2. In 1994 the respondents filed suit against the State of Arkansas in both federal and state court claiming that they were exempt not only from taxes expressly designated in 12 U.S.C. § 2077 (tax imposed on their obligations), but also from Arkansas state sales and income taxes. Respondents requested a declaratory judgment in the United States District Court for the Eastern District of Arkansas that they were exempt from state taxation as "federal instrumentalities" under the Supremacy Clause of the Constitution of the United

States and the doctrine of intergovernmental tax immunity and an injunction against the collection of state taxes by Arkansas. In the Chancery Court of Pulaski County, Arkansas, respondents requested a refund of the taxes they alleged were paid in error as entities exempt from state taxation, based upon the same claim of exemption alleged in district court.

The district court granted respondents' motion for summary judgment holding that PCAs are immune from state taxation as federal instrumentalities and that Congress has not expressly waived that immunity. On appeal, a divided panel of the Court of Appeals for the Eighth Circuit affirmed. The State filed its petition for a writ of certiorari in this Court. At the Court's request, the Solicitor General of the United States filed a brief expressing the views of the United States that the Court should consider granting certiorari to determine whether the Tax Injunction Act permits production credit associations as "federal instrumentalities" to challenge the imposition of state taxes in federal court in the absence of the United States as a co-plaintiff and that the decision of the court of appeals that production credit associations are immune from state taxation calls into question the validity of state court decisions holding that production credit associations in which the federal government holds no ownership interest are subject to state tax.

The Court granted the petition for certiorari in January 1997. In June 1997 the Court issued its opinion in *State of Arkansas v. Farm Credit Services*, 520 U.S. 821 (1997), holding that PCAs are subject to the bar of the Tax Injunction Act (28 U.S.C. § 1341), unless the United States participates on their behalf, and dismissing the federal court action without reaching the merits issue of whether production credit associations are immune from state taxation as federal instrumentalities.

The Arkansas chancery court stayed the proceedings in the refund suit pending the outcome in this Court. Both parties moved for summary judgment when this Court decided *Farm Credit Services*. The chancery court granted respondents' motion for summary judgment, holding that federal instrumentalities are immune from state taxation unless Congress waives that immunity, that PCAs are federal instrumentalities, that Congress did not expressly waive the immunity for production credit associations, and that the PCAs' status as federal instrumentalities renders them immune from state taxation. (P. App. B1-3).

On appeal, the Arkansas Supreme Court affirmed the chancery court's decision that PCAs are immune from state taxation and awarded refunds of tax paid during the statutory refund period. The court held that PCAs are designated as federal instrumentalities by statute from which designation arises an implied immunity from state taxation, that Congress must expressly waive the exemption in order to subject PCAs to state taxation, that the present version of 12 U.S.C. § 2077 does not contain an express waiver of constitutional immunity from state taxation, and that without such a waiver PCAs are exempt from state tax. (P. App. A1-6).

REASONS FOR ALLOWANCE OF THE WRIT

THE SUPREME COURT OF ARKANSAS FAILED TO PROPERLY APPLY THE REASONING EMPLOYED BY THIS COURT IN *ARKANSAS V. FARM CREDIT SERVICES* CONCERNING THE SIGNIFICANCE OF THE STATUTORY DESIGNATION OF A PRODUCTION CREDIT ASSOCIATION AS A FEDERAL INSTRUMENTALITY, RESULTING IN A DECISION THAT PRODUCTION CREDIT ASSOCIATIONS ARE CONSTITUTIONALLY IMMUNE FROM STATE TAXATION AS FEDERAL INSTRUMENTALITIES. THE ARKANSAS DECISION, LIKE THAT OF THE COURT OF APPEALS IN *FARM CREDIT SERVICES*, CALLS INTO QUESTION THE DECISIONS OF OTHER STATE COURTS HOLDING THAT PRODUCTION CREDIT ASSOCIATIONS ARE TAXABLE AFTER GOVERNMENT OWNERSHIP IN THE ASSOCIATIONS CEASES.

The decision of the Arkansas Supreme Court that production credit associations are entitled to constitutional immunity from state taxation is incorrect in two respects. First, the Arkansas court erroneously interpreted 12 U.S.C. § 2077 to provide production credit associations with constitutional immunity from state taxation in the absence of an express waiver of the immunity in the present version of the statute. This interpretation was clearly erroneous, in part because the court disregarded the intent of Congress as expressed in the statute's history and its context in the Farm Credit Act. Second, the Arkansas court failed to apply the reasoning of this Court in *Farm Credit Services* regarding the significance of the statutory federal instrumentality designation, resulting in a decision that federal instrumentality status is, in and of itself, sufficient to entitle PCAs, which are not essential parts of the government, to implied immunity under the intergovernmental tax immunity doctrine.

I. The decision of the Supreme Court of Arkansas that production credit associations are constitutionally immune from state taxation as federal instrumentalities and the decisions of the courts of other states that upheld state taxation of privately owned PCAs result in inconsistent outcomes not intended by Congress when it amended 12 U.S.C. § 2077.

These are the same parties and the same merits issue that were before this Court in *Arkansas v. Farm Credit Services*, 520 U.S. 821 (1997). In his brief for the United States as *amicus curiae* in that case, the Solicitor General noted that the decision of the court of appeals erroneously construed 12 U.S.C. § 2077 in a manner that calls into question the imposition of tax by states on production credit associations following the termination of government ownership in the associations.

The lower court decision in *Farm Credit Services* was the decision of the Court of Appeals for the Eighth Circuit that production credit associations are immune from state taxation as statutorily defined federal instrumentalities in the absence of a waiver of the immunity implied under the Supremacy Clause of the United States Constitution. This Court granted Arkansas' petition for certiorari and held that the instrumentality status of production credit associations does not entitle the associations to the same exemption that the United States has from the Tax Injunction Act's restriction on federal court jurisdiction in the absence of the United States as a co-plaintiff. As a result, this Court did not reach the merits.

The Arkansas state court action seeking refunds of state taxes, which had been stayed during the proceedings in this Court, resumed following this Court's decision in *Farm Credit Services*. The Arkansas Supreme Court, like

the court of appeals, construed 12 U.S.C. § 2077 to hold that production credit associations are constitutionally immune from state taxation in the absence of an express waiver of the implied constitutional immunity in the present version of § 2077.

When Congress established PCAs in 1933, it expressly provided them with two exemptions from federal, state, and local tax. The first exempted the notes, debentures, bonds and other obligations issued by the associations. The second exempted the association itself, its property, its franchises, capital, reserves, surplus and other funds, and its income. Congress conditioned the second exemption upon government ownership (through the Production Credit Corporation) of PCA stock, providing for the exemption to expire when the stock ownership was transferred from the government to the PCA borrowers. Farm Credit Act of 1933, ch. 98, § 63, 48 Stat. 267 (1933).

Although by 1971 when Congress amended the Farm Credit Act the government no longer owned any PCA stock, Congress authorized the Governor of the Farm Credit Administration to purchase PCA stock in financial emergencies. Pub. L. No. 92-181, § 4.0, 85 Stat. 609 (1971). Congress retained both exemptions from tax, the exemption for the obligations of PCAs and the exemption for the associations, their property, and their income that was contingent upon government ownership of PCA stock. Pub. L. 92-181, § 2.17, 85 Stat. 602 (1971).

In 1962 following an assessment of Ohio franchise tax against the Columbus Production Credit Association for the years 1953 (when the government ceased to own stock in the association) through 1959, the Supreme Court of Ohio held that the language of the consent to state taxation in then Section 1138c, Title 12 U.S. Code (Farm Credit Act of 1933)

allowed Ohio to impose its franchise tax on the association. *Columbus Production Credit Ass'n v. Bowers*, 173 Ohio St. 97, 180 N.E.2d 1, cert. denied, 371 U.S. 826 (1962).

In 1964 the Court of Appeals of California, Third District held in *Woodland Production Credit Association v. Franchise Tax Bd.*, 225 Cal. App.2d 293, 37 Cal. Rptr. 231 (1964) that the language of the consent clause in 12 U.S.C. § 1138c (operative after retirement of stock held by the Production Credit Corporation) permits taxation of the association itself and thus a tax measured by the associationís net income "falls within the precise and explicit language of congressional consent." 225 Cal.App.2d at 296. The court observed, "It is difficult . . . to avoid the belief that, once these associations became farmer-owned, Congress meant to place them on a tax parity with comparable, privately held entities." *Id.* at 296. The court recognized that its holding was consistent with that of the Ohio Supreme Court in *Bowers, supra.*

Although the issue of taxation of the associations was not the issue to be decided in those cases, other state court decisions recognized that the associations were subject to state tax. *See Farmers Production Credit Association of South Burlington v. Vermont*, 481 A.2d 18 (Vt. 1984)(association subject to state property transfer tax); *Baker Production Credit Ass'n v. State Tax Comm'n*, 421 P.2d 984 (Ore. 1966)(PCA conceded that it was subject to corporate excise tax following removal of its exemption in 1950).

Congress substantially amended the existing Farm Credit legislation in the Farm Credit Amendments Act of 1985. The amendments included the repeal of the government's authority to own stock directly in PCAs. Pub. L. No. 99-205, § 101, 99 Stat. 1678; H.R. Rep. No. 425, 99th

Cong., 1st Sess., *reprinted in* 1985 U.S. Code Cong. & Admin. News 2601-2602. In a "technical" amendment to 12 U.S.C. § 2077, at the time codified as 12 U.S.C. § 2098, Congress deleted the sentence which exempted the association from taxation and the sentence which conditioned the exemption upon government ownership of association stock. H.R.Rep. No. 425, *supra* at 2615; see Pub. L. No 99-205, § 205, 99 Stat. 1705.

The present statutory language of 12 U.S.C. § 2077, is materially the same as that following the 1985 amendment by the Farm Credit Amendments Act:[1]

> Each production credit association and its obligations are instrumentalities of the United States and as such any and all notes, debentures, and other obligations issued by such associations shall be exempt, both as to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any State, territorial, or local taxing authority, except that interest on such obligations shall be subject to Federal income taxation in the hands of the holder.

12 U.S.C. § 2077 (1989).

All PCAs were privately owned prior to the 1971 amendment to the Farm Credit Act. H. R. Rep. No. 593, 92d Cong. 1st Sess., *reprinted in* 1971 U.S. Code Cong. &

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[1]The Agricultural Credit Act of 1987, Pub. L. No. 100-233, § 401, 101 Stat. 1633, redesignated Section 2098 as Section 2077 without any change to the text. The Agricultural Credit Technical Corrections Act of 1988, Pub. L. No. 100-399, § 401(r), 102 Stat. 998, amended Section 2077 by inserting a comma after "interest" and by adding "except that interest on such obligations shall be subject to Federal income taxation in the hands of the holder" after "authority."

Admin. News 2091, 2098. Thus, at the time Congress amended § 2077 in 1985, the consent language, as interpreted by state courts, had allowed states to tax privately owned PCAs for almost twenty years. The interpretation that the amendment to the statute was not intended to change the taxation of production credit associations is consistent with these state courts' interpretations of the PCAs' tax status at the time of the amendment. *Davis v. Michigan*, 489 U.S. 803, 813 (1989) ("When Congress codifies a judicially defined concept, it is presumed, absent an express statement to the contrary, that Congress intended to adopt the interpretation placed on that concept by the courts.")

Congress established a specific statutory "taxation" section for each of the Farm Credit System entities at the time it established them, and retained these taxation sections, subject to any subsequent amendments. The present taxation sections for farm credit banks (resulting from the mergers of Federal land banks and federal intermediate credit banks), 12 U.S.C. § 2023, and for federal land bank associations, 12 U.S.C. § 2098, were not amended in 1985 when the PCA taxation section and the banks for cooperatives taxation section (then 12 U.S.C. § 2134) were amended. The more extensive immunity afforded those entities is currently expressed for farm credit banks as follows, with similar language for federal land bank associations:

> The Farm Credit Banks and the capital, reserves, and surplus thereof, and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes on real estate held by a Farm Credit Bank to the same extent, according to its value, as other similar property held by other persons is taxed. The mortgages held by the Farm Credit Banks and the notes, bonds, debentures, and other obligations issued by the banks shall be

> considered and held to be instrumentalities of the United States and, as such, they and the income therefrom shall be exempt from all Federal, State, municipal, and local taxation, other than Federal income tax liability of the holder thereof under the Public Debt Act of 1941.

12 U.S.C. § 2023 (1989).

Had Congress intended that, following its amendment to the taxation section in 1985, PCAs have an immunity similar to the immunity Congress extended to other entities within the Farm Credit System, or comparable to the immunity Congress provided to PCAs when the government owned PCA stock, it would likely have amended the statute in a manner to provide that immunity expressly. *See Brown v. Gardner*, 513 U.S. 115, 120 (1994)("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.")(internal quotation marks omitted.)

The effect of the 1985 amendment, according to the Arkansas decision, is to grant constitutional immunity from taxation to production credit associations. The court's statutory construction analysis involved consideration of the present version of 12 U.S.C. § 2077 to determine if a consent to taxation currently existed. "The current version of § 2077 with its silence on the issue [of waiver], compels a holding of immunity because, where Congress is silent, the tax immunity of federal instrumentalities is implied." (P. App. A1-5). "We have examined the language of the statute, 12 U.S.C. § 2077, and hold that it does not contain an express waiver of the tax exemption conferred by the doctrine of intergovernmental tax immunity." (P. App. A1-6).

This language from the opinion reveals that the Arkansas court discounted evidence of congressional intent with regard to the taxation of production credit associations, including the language of the statute prior to its amendment in 1985 and its context within the Farm Credit Act. Consideration of evidence of congressional intent is consistent with the dictates of this Court that it is Congress' province to decide which and to what extent federal instrumentalities are entitled to immunity from state taxation. *See North Dakota v. United States*, 495 U.S. 423, 433 (1990)("The Court has more recently adopted a functional approach to claims of governmental immunity accommodating of the full range of each sovereign's legislative authority and respectful of the primary role of Congress in resolving conflicts between National and State Governments."); *United States v. City of Detroit*, 355 U.S. 466, 474 (1958)("Wise and flexible adjustment of intergovernmental tax immunity calls for political and economic considerations of the greatest difficulty and delicacy. Such complex problems are ones which Congress is best qualified to resolve.")

In *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163 (1989), the Court considered a statute which, like the PCA statute, failed to contain an express waiver of immunity, previously contained therein, after amendment. The Court declined to find that the deletion of the express waiver of immunity indicated that Congress intended to repeal the waiver and "diametrically change course by implicitly barring state taxation." 490 U.S. at 182.

The interpretation of 12 U.S.C. § 2077 adopted by the Arkansas court results in implied immunity as extensive as, if not greater than, the express immunity originally conferred by Congress, but waived when PCAs became privately owned. Such an interpretation is contrary to the

intent of Congress as evidenced by the history of the Congressional treatment of the taxation of PCAs. Further, such an interpretation calls into question decisions of other state courts holding that PCAs are subject to state taxation when they become farmer-owned.

II. The Arkansas Supreme Court's analysis of whether the statutory designation of a PCA as a federal instrumentality is, in and of itself, sufficient to exempt a PCA from state tax in the absence of consent failed to properly apply the reasoning employed by this Court in *Arkansas v. Farm Credit Services* concerning the significance of the statutory designation of a PCA as a federal instrumentality.

This Court has not decided whether statutory designation of an entity as a federal instrumentality alone entitles such an entity to implied immunity from state taxation. However, in *Farm Credit Services* the Court held that the statutory designation of PCAs as federal instrumentalities is not sufficient for purposes of the immunity the government enjoys from the Tax Injunction Act. The reasoning in that opinion suggests that the instrumentality designation is not sufficient for purposes of implied immunity of PCAs from state taxation, especially when considered in conjunction with the indications that Congress intended PCAs to become subject to state tax when government ownership terminated.

Although the Court did not reach the taxation issue in *Farm Credit Services*, the Court clearly stated that although the statutory designation is significant, statutory instrumentality status alone is not sufficient to confer upon such an entity all of the rights and privileges of the United States.

> True, important consequences flow from the congressional decision to designate a PCA formed pursuant to statute as "an instrumentality of the United States." The tax immunity a PCA has under § 2077 is a permitted consequence of its status as a federal instrumentality. An instrumentality of the United States can enjoy the benefits and immunities conferred by explicit statutes, however, without the further inference that the instrumentality has all of the rights and privileges of the National Government.

Farm Credit Services, 520 U.S. at 829.

In deciding that instrumentality status is not sufficient to entitle production credit associations to the same exemption the United States has under the Tax Injunction Act, the Court considered the governmental nature of PCAs to be significant.

> The PCAs' business is making commercial loans, and all their stock is owned by private entities. Their interests are not coterminous with those of the Government any more than most commercial interests. Despite their formal and undoubted designation as instrumentalities of the United States, and despite their entitlement to those tax immunities accorded by the explicit statutory mandate, PCA's do not have or exercise power analogous to that of the NLRB or any of the departments or regulatory agencies of the United States.

Farm Credit Services, 520 U.S. at 831- 832.

In a case in which an entity other than a statutory federal instrumentality sought exemption from state taxation as a tax-immune federal instrumentality, the Court examined

the governmental nature of the entity to determine whether it should be immune. For example, in *Department of Employment v. United States*, 385 U.S. 355, 358-359 (1966), the Red Cross claimed it was a federal instrumentality and was immune from state withholding tax. The Court relied on the Federal charter of the Red Cross, government supervision and regulation of the Red Cross, the appointment of its principal officer and seven of its 49 governors by the President, its obligation to perform a wide variety of functions indispensable to the workings of the armed forces, its receipt of substantial material assistance from the Federal Government, and a recognition that the President and Congress have recognized the "Red Cross' status virtually as an arm of the Government" to determine that the Red Cross was sufficiently necessary to the continued operations of the government to be immune from state tax. *Id.*, 385 U.S. at 359-360. The Court stated, "there is no simple test for ascertaining whether an institution is so closely related to governmental activity as to become a tax-immune instrumentality." *Id.*, 385 U.S. at 358-359 (1966).

The Arkansas Court did not apply this reasoning in its decision, instead concluding that the statutory designation of production credit associations as federal instrumentalities is sufficient to entitle them to implied immunity. In its opinion the Arkansas court stated:

> PCAs are federal instrumentalities, clearly designated as such by federal statutes. Once it has been determined that the PCAs are federal instrumentalities, there arises an implied immunity from state and local taxation. *M'Culloch v. Maryland, supra.* In order to subject federal instrumentalities such as PCAs to state taxation, Congress must enact a clear waiver of their exemption. *Department of Employment v. United States*, 385 U.S. 355 (1966). (P. App. A1-5).

This Court's recent decisions concerning the issue of intergovernmental tax immunity have focused on limiting the immunity to state taxes that are imposed directly on the Federal Government or which discriminate against it. *See, e.g., Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 811 (1989)("After Graves, therefore intergovernmental tax immunity barred only those taxes that were imposed directly on one sovereign by the other or that discriminated against a sovereign or those with whom it dealt.")

A decision such as the Arkansas decision that establishes immunity in the absence of Congressional waiver based solely upon Congress' designation of the entity as a federal instrumentality is contrary to the reasoning in *Farm Credit Services* and to the evolution of the intergovernmental tax immunity doctrine as interpreted by this Court.

CONCLUSION

For the foregoing reasons, it is respectfully suggested that the Court review the issue of whether the statutory designation of a production credit association as a federal instrumentality is sufficient, in and of itself, to bestow upon the association constitutional immunity from state taxation, especially where the intent of Congress, as expressed in 12 U.S.C. § 2077 prior to the 1985 amendment, indicates that Congress intended to subject the associations to state taxation once government ownership in the associations ceased, and that the Court reverse the decision of the Supreme Court of Arkansas that the associations are entitled to constitutional immunity from state taxation.

Respectfully submitted,

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APPENDIX A

SUPREME COURT OF ARKANSAS
No. 98-1518

STATE OF ARKANSAS,
APPELLANT,

VS.

FARM CREDIT SERVICES OF CENTRAL ARKANSAS, *ET AL.*
APPELLEE,,

OPINION DELIVERED
JUL 01 1999

APPEAL FROM THE PULASKI COUNTY CHANCERY COURT, NO. 94-493 1 HON. ALICE S. GRAY, JUDGE.

AFFIRMED.

RAY THORNTON, Associate Justice

The State of Arkansas, appellant, brings this appeal of the decision of the Pulaski County Chancery Court which found that appellees,, four Production Credit Associations, are entitled to immunity from state sales and income taxation by virtue of their status as "federal instrumentalities." Because we agree with the chancery court that absent express congressional waiver, the PCAs are entitled to immunity from state taxation, we affirm the chancellor's grant of appellees" summary judgment motion.

Appellees, Farm Credit Services of Central Arkansas, Farm Credit Services of Western Arkansas, Eastern Arkansas Production Credit Association, and Delta Production Credit Association, are Production Credit Associations (PCAs), corporations chartered under the Farm Credit Act of 1971. These corporate financial institutions, organized by ten or more farmers to provide loans and other banking services to farmers, are entities of the Farm Credit System, a government-sponsored enterprise created by Congress in 1916. The Federal Farm Loan Act, Pub. L. No. 64-158; 39 Stat. 360 (1916). In 1933 Congress established Production Credit Associations to carry out the federal purposes of providing agricultural credit to American farmers, and for a time, the government owned stock in PCAs in order to encourage and assist the PCAs. *See* H.R. Rep. No. 593, 92d Cong. 1st Sess. 8 (1971), Farm Credit Act of 1933, ch. 98, § 23, 48 Stat. 261.

The Farm Credit Act, Pub. L. No. 73-98; 48 Stat. 257 (1933), established twelve district federal land banks to make long-term loans to farmers through federal land bank associations. PCAs are designated by 12 U.S.C. §§ 2017 and 2077 as "federal instrumentalities." Each association is a member of the Farm Credit System, which is divided into seven districts. Arkansas is part of the seventh farm credit district, known as Agribank,, and is divided into four farm credit territories. Each association is restricted to certain territories outlined in its charter, and they are limited to making agricultural-purpose loans only to farmers who are members, operating on a cooperative basis.

In 1994, appellees,, the four Arkansas PCAs, requested a refund of state income and sales taxes paid within the refund limitations period, claiming that they paid the taxes in error, because their status as "federal instrumentalities" exempts them from state taxation under

the constitutional doctrine of intergovernmental tax immunity. Appellant, through the Department of Finance and Administration (hereinafter "The Department,") denied their request. The PCAs brought suit in the Pulaski County Chancery Court contesting the denial of the refund.[1] Both parties moved for summary judgment. On July 1, 1998, the trial court granted the PCAs' motion, holding that PCAs are federal instrumentalities immune from state tax unless Congress waives that immunity, that Congress has not expressly waived that immunity for PCAs, and, therefore, that their status as federal instrumentalities renders them exempt from state taxation. The judgment ordered the Department to refund state income and sales taxes to the

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[1]The PCAs simultaneously filed suit in the United States District Court for the Eastern District of Arkansas against the State of Arkansas, seeking a declaratory judgment that they were exempt from state taxation and for an injunction against collection of future taxes. In 1995, in an unreported decision, United Stated District Judge Henry Woods granted the PCAs motion for summary judgment, finding that their statutory designation as a federal instrumentality exempts them from state taxation under the implied immunity doctrine and that states cannot tax them in the absence of a statute which clearly and affirmatively waives this implied immunity. The Department appealed to the United States Court of Appeals for the Eighth Circuit, which upheld the district court's decision. *Farm Credit Services of Central Arkansas, PCA et al. v. State of Arkansas*, 76 F.3d 961 (8th Cir. 1995).

The PCAs then moved for summary judgment in Pulaski County Chancery Court, on the grounds that appellant was collaterally estopped by the Eighth Circuit decision from relitigating the legal issue of the PCAs' entitlement to exemption. The Department responded with a petition for writ of *certiorari* to the United States Supreme Court, which was granted. The Pulaski County Chancery Court stayed its decision pending the outcome of the Supreme Court case. The Supreme Court did not address the merits of the exemption issue but held that the federal court lacked jurisdiction under the Tax Injunction Act, 28 U.S.C. § 1341, to consider the merits when the question could be presented to a state court, and when the instrumentality was not joined by the United States as a co-plaintiff. *Arkansas v. Farm Credit Services of Central Arkansas, et al.*, 520 U.S. 821 (1997).

PCAs; the total sum at issue amounts to more than $1.2 million dollars, plus ten percent interest. The Department filed this appeal, contending that the trial court erred by deciding the issue of the PCAs' exemption from state tax based upon the doctrine of intergovernmental tax immunity, as expressed and developed in *M'Culloch v. Maryland,* 17 U.S. (4 Wheat.) 316 (1819) and its progeny, rather than upon 12 U.S. § 2077, a statutory exemption from federal and state taxation granted by Congress. In the alternative, the Department asserts that the trial court erred in holding that federal instrumentality status, in and of itself, is sufficient to entitle PCAs, who they assert are not essential parts of government, to implied immunity under the tax immunity doctrine. The Department does not, however, challenge the constitutionality of the federal statute on the basis that Congress lacked authority to designate PCAs as instrumentalities of the United States, but, rather, asks us to construe the statute itself and conclude that notwithstanding their designation as an "instrumentality," the PCAs are taxable.

This court reviews issues of statutory construction *de novo;* it is for this court to decide what a statute means.Arkansas Depit.of Health v.Westark Christian Action, 322 Ark. 440, 910S.W.2d 199 (1995). We are not bound by the decision of the trial court. However, in the absence of a showing that the trial court erred in its interpretation of the law, that interpretation will be accepted as correct on appeal. *Bryant v. Weiss,* 335 Ark. 534, 983 S.W.2d 902 (1998). The statute at issue reads:

> Each production credit association and its obligations are instrumentalities of the United States and as such any and all notes, debentures, and other such obligations issued by such associations shall be exempt, both as to principal and interest, from all

> taxation (except surtaxes, estate, inheritance, and gift taxes) now and hereafter imposed by the United States or by any State, Territorial, or local taxing authority, except that interest on such obligations shall be subject to Federal income taxation in the hands of the holder.

12 U.S.C. § 2077 (1989).

As the Supreme Court first held *in M'Culloch v. Maryland, supra,* because of the Supremacy Clause of the United States Constitution, states have no power to tax federally-created instrumentalities absent congressional authorization. "[T]he states states have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government. This is, we think, the unavoidable consequence of that supremacy which the constitution has declared." *Id.* The doctrine of intergovernmental tax immunity is well understood, based upon principles of dual sovereignty. Our federal government is immune from taxation imposed by the state, unless that immunity is waived, explicitly or expressly, by a statutory waiver of that immunity. *Federal Reserve Bank of St. Louis v. Metrocentre Improvement Dist.* #1, 657 F.2d 183 (8th Cir. 1981)(citing *United States v. City of Adair,,* 539 F.2d 1185 (8th Cir. 1976), *cert. denied* 429 U.S. 1121 (1977), *affd, 455* U.S. 995 (1982).

PCAs are federal instrumentalities, clearly designated as such by federal statutes. Once it has been determined that the PCAs are federal instrumentalities, there arises an implied immunity from state and local taxation. *M'Culloch v. Maryland, supra.* In order to subject federal instrumentalities such as PCAs to state taxation, Congress must enact a clear waiver of their exemption. *Department of Employment v.*

United States, 385 U.S. 355 (1966). Once federal immunity from taxation is established, Congress must express any waiver of that immunity as a "clear, express, affirmative desire." *Federal Reserve Bank of St. Louis, supra.*. We note that 12 U. S.C. § 2077 does not contain an express waiver of constitutional immunity from taxes derived from the doctrine of intergovernmental tax immunity.

The current statutory enactment by Congress dealing with state taxation of PCAs states that "all notes, debentures, and other obligations" of the associations are exempt from state and federal taxation. 12 U.S.C. § 2077. The Department contends that because prior versions of the statute expressly exempted their "capital, reserves, surplus, and other funds, and their income," Farm Credit Act of 1971, Pub. L. No. 92-181, § 2.17, 85 Stat. 583 (1971); Farm Credit Act of 1933, Pub. L. No. 73-75, § 63, 48 Stat. 257 (1933), and the current statutory provision no longer contains such additional immunity language, Congress has waived the PCAs' exemption. However, we do not find that argument persuasive. The current version of § 2077, with its silence on the issue, compels a holding of immunity because, where Congress is silent, the tax immunity of federal instrumentalities is implied. *See Graves v. New York ex ref. O'Keefe,* 306 U.S. 466 (1939). *See also Farm Credit Services of Mid-America v. Department of State Revenue,* 705 N.E.2d 1089 (Indiana Tax Ct. 1 999)(Because Congress had not waived the Agricultural Credit Association's immunity from state taxation, under the Supremacy Clause, Indiana was without power to collect state tax from the association. "With respect to federal instrumentalities, it is the waiver and not the immunity which must be explicit.") We have examined the language of the statute, 12 U.S.C. § 2077, and hold that it does not contain an express waiver of the tax exemption conferred by the doctrine of intergovernmental tax immunity.

We have concluded that the decision of the Pulaski County Chancery Court in granting the PCAs' motion for summary judgment was correct and affirm the judgment in their favor for the refund of amounts paid as state income taxes and state sales taxes.

Affirmed.

APPENDIX B

IN THE CHANCERY COURT OF PULASKI COUNTY
ARKANSAS FIRST DIVISION

FARM CREDIT SERVICES OF CENTRAL ARKANSAS, PCA; FARM CREDIT SERVICES OF WESTERN ARKANSAS, PCA,- EASTERN ARKANSAS PRODUCTION CREDIT ASSOCIATION; and DELTA PRODUCTION CREDIT ASSOCIATION

PLAINTIFFS

vs.

NO. 94-4931

STATE OF ARKANSAS

DEFENDANT

ORDER

On this date came on to be heard Plaintiffs' Motion for Summary Judgment and Defendant's Motion for Summary Judgment. Plaintiffs appeared represented by Charlie Compton and by and through their attorneys, Mark Nichols and Rufus Wolff. Defendant appeared by and through its attorneys, Martha Hunt and Mary Cameron. From the pleadings, the Court Finds and Orders as follows:

It is undisputed by the parties that the Plaintiffs are federal instrumentalities. Plaintiffs are production credit associations (PCAs) chartered by the Farm Credit Act of 1971. 12 U.S.C. sections 2071 and 2077. PCAs are identified as federal instrumentalities in three parts of the Farm Credit Act of 1971. 12 U.S.C. sections 2071 (a), (b)(7), 2077. Therefore, UPCA's are instrumentalities of the United States because the statute which charters them says so." *Arkansas*

v. Farm Credit Services, 520 U.S._____,_____, 138 L. Ed. 2d 34, 39, 117 S. Ct._____, _____ (1997).

It is long established that federal instrumentalities are immune from state taxes unless Congress specifically waives that immunity. *McCulloch v Maryland,* 17 U S 316 (1819). Therefore, the doctrine of tax immunity announced in *McCulloch* applies when a statute is silent on taxation. Congress addresses tax exemption for the PCAs in only one section of the United States Code.

Each production credit association and its obligations are instrumentalities of the United States and as such any and all *notes. debentures. and other obligations issued by such associations shall be exempt,* both as to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any State, territorial, or local taxing authority, except that interest on such obligations shall be subject to Federal income taxation in the hands of the holder. 12 U S C section 2077 (emphasis added). While "notes, debentures, and other obligations issued by such associations" are specifically exempted from most state taxation, the only express *waiver* of immunity from state taxation contained in the section applies solely to surtaxes, estate taxes, inheritance taxes and gift taxes imposed on those notes, debentures and other obligations Thus Congress provides no express waiver of immunity from state income and sales taxes for the PCAs Defendant argues that mere designation as a federal instrumentality in a statute is insufficient in itself to confer tax exempt status. Defendant contends that only federal instrumentalities which are sufficiently connected to the National Government are entitled to implied governmental immunity from taxation. Yet the Defendant is unable to direct the Court to a case in which an entity that Congress specifically designated a federal instrumentality was required

to established its connection with the National Government before proving its entitlement to state tax exemption.

"[W]here there is federal immunity from taxation, Congress must express a clear, express, and affirmative desire to waive that exemption." *Federal Reserve Bank of St. Louis v. Metrocentre Improvement Dist. #1*, 657 F.2d 183, 186 (1981). Because Congress provided no express waiver of immunity from state income and sales taxation in any statute, the PCAs' status as federal instrumentalities renders them exempt from such taxation.

Accordingly, Plaintiff's Motion for Summary Judgment should be, and hereby is, granted. Defendant's Motion for Summary Judgment is denied for the foregoing reasons.

IT IS SO ORDERED.

ALICE S. GRAY, CHANCELLOR

DATE JUN 1998

APPENDIX C

12 U.S.C. § 2071. Organization and charters

(a) Charter

Each production credit association shall continue as a Federally chartered instrumentality of the United States. ((b)) Organization

(1) In general

Production credit associations may be organized by 10 or more farmers or ranchers or producers or harvesters of aquatic products desiring to borrow money under the provisions of this part.

(2) Articles of association

The proposed articles of association shall be forwarded to the Farm Credit Bank for the district accompanied by an agreement to subscribe on behalf of the association for stock in the bank in such amounts as may be required by the bank.

(3) Contents of articles

The articles shall specify in general terms the -

(A) objects for which the association is formed;

(B) powers to be exercised by the association in carrying out the functions authorized by this part; and

(C) territory the association proposes to serve.

(4) Signatures

The articles shall be signed by persons desiring to form such an association and shall be accompanied by a statement signed by each such person establishing eligibility to borrow from the association in which such person will become a stockholder.

(5) Copy to FCA

A copy of the articles of association shall be forwarded to the Farm Credit Administration with the recommendations of the bank concerning the need for such an association in order to adequately serve the credit needs of eligible persons in the proposed territory and whether that territory includes any area described in the charter of another production credit association.

(6) Denial of charter

The Farm Credit Administration for good cause shown may deny the charter.

(7) Approval of articles

On approval of the proposed articles by the Farm Credit Administration, and on the issuance of a charter, the association shall become as of such date a federally chartered body corporate and an instrumentality of the United States.

(8) Powers of FCA

The Farm Credit Administration shall have the power, under rules and regulations prescribed by the Farm Credit Administration or by prescribing in the terms of the charter, to

(A) provide for the organization of the association;

(B) province for the initial amount of stock of the association;

(C) provide for the territory within which the association's operations may be carried on; and

(D) approve amendments to the charter of the association's

12 U.S.C. § 2077. Taxation

Each production credit association and its obligations are instrumentalities of the United States and as such any and all notes, debentures, and other obligations issued by such associations shall be exempt, both as to principal and interest, from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States or any State, territorial, or local taxing authority, except that interest on such obligations shall be subject to Federal income taxation in the hands of the holder.